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C O N F I D E N T I A L SECTION 01 OF 04 ABU DHABI 001898

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TREASURY FOR U/S MCCORMICK, U/S LEVEY, A/S LOWREY, A/S
OBRIEN, A/S GARDNER, DAS SAEED, DAS SOBEL, DAS DALY, DAS
BARTH, DAS MENDELSOHN, KMATHIASEN, JROSE, RKAPROTH, MTURNER
NSC FOR ZARATE, NRAMCHAND
STATE FOR NEA/IR, NEA/ARP
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TAGS: AE ECON EFIN KTFN PREL PTER EINV
SUBJECT: UAE SKEPTICISM ON SOVEREIGN WEALTH INITIATIVES;
INVESTMENT FIRMS LAMENT POLITICAL RISK IN THE U.S.

REF: ABU DHABI 1696

ABU DHABI 00001898 001.2 OF 004

Classified By: Ambassador Michele J. Sison, for reasons 1.4 b and d.

¶1. (C) Summary. UAE government and finance officials remain skeptical over U.S. and international sovereign wealth fund initiatives, but eagerly await additional details to further evaluate. UAE-based investment firms cite increased political risk surrounding foreign investment in the U.S., and are passing on U.S. deals as a result. The declining dollar contributes to UAE's inflation numbers, and hurts expatriate workers, but de-pegging from the dollar does not appear to be on the horizon. Dubai businesses feeling pain and uncertainty over U.S. financial measures targeting Iran. End Summary.

¶2. (C) On October 29 and 30, a delegation led by David McCormick, Treasury Under Secretary for International Affairs, visited Abu Dhabi and Dubai to discuss U.S. open investment policy and build support for an IMF-led process to develop voluntary best practices for sovereign wealth funds (SWF). In addition, McCormick pressed for a smaller group, led by the U.S., UAE and Singapore, to begin SWF consultations in an effort to jumpstart the multilateral process. McCormick and his delegation met with Sheikh Ahmed bin Zayed al Nayhan, Managing Director of the Abu Dhabi Investment Authority (ADIA); Dr. Mohammed bin Khalfan bin Khirbash, Minister of State for Finance; Sheikha Lubna Al Qassimi, Minister of Economy; Sultan bin Nasser Al Suwaidi, Central Bank Governor; Khaldoon Khalifa Al Mubarak, CEO Mubadala; Mohammed Gergawi, Minister of State for Cabinet Affairs and CEO of Dubai Holding; Obaid al Tayer, Chairman of the Dubai Chamber of Commerce and Industry (DCCI); Omar bin Sulaiman, Governor of the Dubai International Financial Centre (DIFC); Sylvain Denis, CEO of Private Equity for Dubai International Capital (DIC); and David Jackson, CEO Istithmar. McCormick also raised the new U.S. sanctions on Iran and highlighted the risks of conducting business with Iranian entities.

U.S. Open Investment Policy

¶3. (C) During meetings with government and finance officials, U/S McCormick stressed that despite high profile setbacks such as Dubai Ports World, the U.S. remained committed to an open investment environment. McCormick pointed to the President's May 2007 Statement on Open Economies, the new Committee of Foreign Investment in the United States (CFIUS) legislation, and the number of successful cross-board investment transactions in 2006 as evidence that the U.S. continues to welcome foreign investment. McCormick also pressed for voluntary best practices covering sovereign wealth funds, stating that doing nothing is no longer an option in the face growing international concern stoked by media coverage. McCormick's message was met with a variety of responses, ranging from commitments to continue investing in the U.S. to warnings on substantially disrupted investment flows due to the current political atmosphere surrounding foreign investment in the U.S.

Sovereign Wealth Fund Troika Proposal

¶4. (C) McCormick proposed that in order to jumpstart the IMF-led best practices effort, the U.S, UAE and Singapore could begin quiet consultations as regional leaders to outline investment principals for SWFs. McCormick stressed that action needed to be taken to get out in front of developing protectionist sentiments that could result in unilateral measures unduly restricting foreign investment flows in the U.S., Europe, Asia and Russia.

¶5. (C) Stressing the importance of cooperation and appreciation for U.S. efforts, ADIA head Sheikh Ahmed stated that he preferred to avoid appearances of secrecy or exclusion. On the issue of IMF best practices more generally,

Sheikh Ahmed gently advised that he understood the concerns raised by U/S McCormick, but that it was important to understand the actual situation before taking action, and that all parties must be careful not to go too far. Sheikh Ahmed asked for additional details on the proposals in writing and informed that any final decision would need to be approved by UAE President Sheikh Khalifa bin Zayed and Crown Prince Sheikh Mohammed bin Zayed. McCormick promised to pass a concept paper outlining the proposal for further consideration. (Note: Sheikh Ahmed was joined at the meeting by Hareb al Darmaki, who attended the October G-7 SWF outreach dinner. The troika proposal did not appear to catch Sheikh Ahmed by surprise, and his reaction thereto appeared considered. End note.)

¶6. (C) In response to the troika proposal, Mubadala head Khaldoon stated that he would need to survey views across Abu Dhabi on such an exercise. Khaldoon strongly agreed that steps need to be taken to protect cross-boarder investment flows, and was open to considering all options. Khaldoon worried openly about engaging in an exercise that would associate his fund with other funds that merited concern, such as Chinese and Russian entities. (Note: Mubadala has greater incentive to embrace a proactive solution to the SWF issue, as Mubadala's investment mandate involves higher-profile transactions and controlling stakes more likely to attract unwanted political and media attention, such as the purchase of 7.5% of the Carlyle Group. Alternatively, ADIA will likely avoid investments that may attract negative attention, and therefore may feel more secure trying to stay under the radar during this current period of increased attention. End note.)

¶7. (C) Sheikha Lubna reacted more sharply to the Treasury proposals. Sheikha Lubna expressed skepticism that best practices would quell the protectionist tide, and worried that instead they could become a tool to justify investment restrictions in many countries. She rejected overly broad

assessments labeling UAE-based investment firms, other than ADIA, as sovereign wealth funds, and advised that rising protectionism was only a problem in the U.S. Sheikha Lubna warned that new restrictions would simply result in Emirati funds moving elsewhere in search of lower risk, higher return investments. Sheikha Lubna opined that the political issues driving protectionist sentiments were local in essence, cautioned against endorsing a remedy without knowing possible outcomes, and encouraged a U.S. solution for this U.S. problem. Sheikha Lubna requested more information on what possible guidelines would look like, as well as the details of the troika proposal.

¶8. (C) Minister of State for Finance Dr. Khirbash conveyed his surprise by the concern in recipient countries over sovereign wealth investing and emphasized that he is not prepared to &open his checkbook8 to everyone. He suggested that the most straightforward solution would be to designate certain sectors as off-limits to UAE investors. U/S McCormick highlighted that this is exactly the type of protectionist response we are trying to avoid in the US and elsewhere, and noted further that the US has always believed that it is in our interest to keep our markets open, regardless of the investment climate in the investor,s country. Dr. Khirbash recalled that following the rise in oil prices in the late 1990s, GCC countries were called upon to invest the surplus wisely. With rising revenues, UAE also heeded calls for OPEC countries to increase production capabilities. Dr. Khirbash encouraged further dialogue on the SWF issue as a means to mitigate the need for action. Dr. Khirbash requested a working paper proposal for the UAE to review and respond.

Political Risk in the U.S.: the "X" Factor

¶9. (C) Investment firms Mubadala, Dubai International Capital (DIC) and Istithmar described an increased level of uncertainty surrounding potential U.S. investments due to the

current political attention on foreign investment. Mubadala executives now factor in political risk for every U.S. deal, a criterion typically reserved for unstable investment environments. Mubadala CEO Khaldoon openly worried that at some point investing in the U.S., or in entities with U.S. operations, would become not good business, as more and more U.S. deals fall outside of their investment parameters. Mubadala cited soaring costs for lawyers, lobbyists and consultants for each U.S. deal. At the same time dramatic and sincere, Khaldoon asked point blank whether Mubadala should avoid investing in the U.S. for a period of time until circumstances change.

¶10. (C) DIC, labeling this risk the "X" factor, informed that it no longer considers making investments that will trigger CFIUS review. DIC stated that CFIUS provisions demanded by target companies are creating excessive risks, for example a USD $100 million penalty should a transaction fail to successfully exit the CFUIS process. DIC was concerned that financial partners were backing away from deals with DIC because of the increased uncertainties and delays in closing. DIC added that during a recent negotiation, the CFIUS provisions took over a week to resolve. DIC was caught off guard by the uncertainties arising from the Bourse Dubai transaction and the lack of clarity on what is meant by "critical economic infrastructure." This development caused DIC to carefully reconsider all U.S. investing as the goal posts seemed to move to reflect political winds. DIC's outside counsel is now advising that DIC must file all U.S. transactions with CFIUS because it is viewed as government-owned.

¶11. (C) DIFC Governor Omar bin Sulaiman advised that the most significant question was how many deals were not pursued as a result of the current political climate and PR concerns,

stating that he was aware of at least dozen from his participation on various corporate boards. Sulaiman described uncertainty as to what types of investments were welcome and what should be avoided.

¶12. (C) Istithmar CEO David Jackson explained the perception that there are two sets of rules for foreign investment in the U.S.: one for UK, France and other Western investors; and another for China, Arabs, etc. For example, the Dubai Ports chapter sent the message that it was acceptable for a UK company to own a U.S. port facility, but not an Arab firm. Jackson believed that the ultimate beneficiaries of the current uncertainty surrounding the U.S. market were Asian economies, such as China, as they welcomed increased foreign investment. Jackson questioned fears over sovereign wealth investors, believing that business and economic fundamentals will ultimately squeeze out any actors pursuing political, rather than financial, objectives.

Currency Peg and the Declining U.S. Dollar

¶13. (C) In a typically confrontational exchange, Central Bank Governor Al Suwaidi relayed the growing pressure he faces internally on UAE monetary policy, partially as a result of the declining value of the U.S. dollar. Al Suwaidi cited tremendous daily pressure on inflation and the declining dirham, specifically citing South Asian journalists representing the interests of expatriate workers whose monthly remittances were falling. (Note: The UAE maintains a fixed exchange rate regime, pegging the dirham to the U.S. dollar. As the dollar has fallen versus several major international currencies, so has the dirham against the Indian and Pakistani rupees. End note.) Al Suwaidi asked where the dollar was heading and queried not so subtly if at some valuation the USG would intervene. Al Suwaidi bluntly asked for U/S McCormick's views on UAE's dollar peg and whether de-pegging would concern the USG. Upping the ante, he advised McCormick that a de-pegging would result in Emirati petrodollars exiting New York to rebalance against whatever currency basket was adopted in place of the dollar peg. McCormick stated that UAE's choice of exchange rate regime

was a sovereign decision meriting careful consideration, but that the Treasury Department did not want to be surprised by UAE actions. (Note: While Governor Al Suwaidi is under significant pressure from daily headlines on rising inflation and the falling dollar, regional bankers and investment professionals largely agree that UAE is unlikely to de-peg or revalue unless Saudi Arabia moves first. The dollar peg is as much as political statement in the UAE as a monetary policy. End note.)

¶14. (C) In a separate meeting, Minister of State for Finance Dr. Khirbash stated that within the GCC, there is no discussion on moving away from the dollar peg.

Financial Measures on Iran

¶15. (C) During separate conversations with the Central Bank Governor and Dubai Chamber of Commerce and Industry (DCCI), U/S McCormick raised the recent USG sanctions targeting Iranian entities involved in proliferation and terrorist support activities, as well as the recent FATF advisories regarding the risks posed by the Iranian financial system and Iranian accounts. Governor Al Suwaidi repeated to McCormick the information he conveyed to Treasury U/S Levey earlier in the month, primarily that the Central Bank noticed a decline in financial transactions between UAE and Iran for the month of August. Without providing further details, Al Suwaidi believed that this trend proved that UAE was not attracting additional Iranian capital in the face of growing international restrictions. Al Suwaidi speculated that either Iran was retrenching, or was simply moving its business

elsewhere.

¶16. (C) DCCI head Obaid Al Tayer described an atmosphere of uncertainty in Dubai with regards to U.S. financial measures on Iran and other U.S. legislation that could potentially affect trade and investment, such as the PATRIOT Act (NFI). Al Tayer explained that Dubai merchants are very cautious in dealing with U.S. companies as they fear unwittingly violating U.S. laws, adding that the U.S. Department of Justice is looking at all companies in Dubai that deal with Iran (NFI). Al Tayer stated that U.S. companies are now requiring Dubai-based firms to provide indemnities for violation of U.S. sanctions on Iran. DCCI asked for additional guidance on U.S. regulations pertaining to Iran. (Note: Consulate Dubai and Treasury Section Abu Dhabi will be leading information sessions for DCCI members on U.S. regulations pertaining to Iran. End note.)

¶17. (C) DCCI participants speculated that the U.S. measures will impact the people and private sector in Iran, but not the Iranian regime or its decision making. DCCI lamented the harm to Emirati businesses in the process. DCCI stressed that the U.S. is an important trade partner and ally of the UAE, but that Dubai also welcomes Iranian investment.

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